

## **Proposed Changes To “Rent-A Room” Relief (Lecture B1092 – 8.55 minutes)**

The rent-a-room scheme has now been with us for over a quarter of a century (apologies if, like me, this makes you wonder where that time went).

The original intention of the scheme was to increase the quantity and variety of low-cost rented housing and make it easier for people to move around the country for work. As a by-product, it also made it much easier for landlords to calculate the profits arising from the letting of a room in their own home.

Before 1992, profits had to be calculated by apportioning expenses between the “family” bit of the house and the part of the house let to the lodger, a process which involved scientifically plucking a number out of the air then multiplying it by two and rounding down a bit in case HMRC queried it.

Since April 1992, landlords with lodgers can still choose to prepare a normal property income computation (nowadays using the cash or accruals basis as appropriate) by taking annual rents and deducting any expenses relating to the letting to give a profit or loss.

However most individuals renting out a room in their home prefer instead to take the hassle-free route and calculate profits by simply deducting the annual rent-a-room limit from the annual rents and paying tax on the excess. To this end the rent-a-room limit stands in place of all allowable expenses and circumvents any need to both work out the expenses which relate to the letting or to keep any accompanying records.

The rent-a-room limit was £3,250 until April 1997 and then £4,250 until April 2016 at which point it was generously hiked to £7,500 (which the Government was quick to point out exceeded the average annual cost of renting a room in the UK by over £1,000 a year). What the government was less keen to acknowledge was that this threshold had severely lagged-behind the average cost of renting a room in the UK for the best part of the last decade but that’s water under the bridge.

The rent-a-room scheme is only available if the landlord is letting out a room in his only or main residence. Landlord and tenant must therefore be living in the same property, thereby making the tenant a lodger of the landlord.

Where gross rents do not exceed the £7,500 limit, rent-a-room relief applies automatically thereby making the rental income exempt from tax. There is no requirement for taxpayers to report this income. If allowable expenses exceed gross rents, the landlord can claim for the relief not to apply. This will crystallise an allowable loss to either set against profits from the rest of his UK property business or be carried forward against future rental profits.

Where gross rents exceed £7,500, a claim must be made for rent-a-room relief to apply. The claim is typically made via the self-assessment return. The relief will then continue to apply each year until the claim is withdrawn.

The £7,500 limit applies per property and not per tenant.

If a property is jointly owned, half the rent-a-room limit is given to each joint owner (even if the rents are apportioned differently). This is a quirky rule as each joint owner receives half the threshold even in cases where there are more than two joint owners. While this seems like a chance to make hay, planning opportunities here are limited.

The rent-a-room scheme only applies to residential accommodation. It does not apply where a room is used as an office or for any kind of business.

If rent-a-room relief applies, it does not normally affect the availability of Principal Private Residence relief when the owner comes to sell the property. The landlord is treated for PPR purposes as having occupied the part of the house let to the lodger. Care must however be taken if the landlord takes in two or more lodgers as the HMRC CGT Manual at CG64702 says that in this case the landlord will be treated as running a business and PPR relief would then be restricted.

Note also that the property in respect of which rent-a-room relief is claimed does not have to be the same as the one that is the landlord's only or main residence for PPR purposes. For example, an individual with two residences may be letting out a room in his main residence but his second home could be his PPR by nomination. This does not prejudice rent-a-room relief.

### *The Consultation*

Since 1992, the private rental sector has doubled in size. The emergence of online marketplaces and digital platforms such as SpareRoom.co.uk, Roombuddies.co.uk and Airbnb has made it easy for those with spare accommodation in their home to access a global network of potential occupants and make a few quid by renting out a space which would otherwise have been occupied by some empty suitcases, an ironing board and a Swiss ball.

The Government therefore opened a Consultation in 2017 to see if the rent-a-room scheme was still fit for purpose with the aim of:

Finding out more about the use of the relief including who uses the scheme, what kinds of letting activity they are carrying out and why they might choose to let spare accommodation in their main residence;

Establishing whether the relief is working as the government intends and whether rent-a-room continues to be an appropriate relief; and

Looking at potential reform of the relief by taking views on the effectiveness of the relief, what its role should be in the modern housing market, and whether there is consensus around potential reform.

### *The Feedback*

The Government received 178 written responses from individual users of the relief, tax and accountancy groups, trade bodies, accommodation sharing platforms and charities. The feedback has led to the publication of draft legislation intended to take effect from 6 April 2019.

The good news is that rent-a-room relief will be retained with only minor changes. Responses indicated that most individuals would not be prepared to let out their spare rooms if the relief was not available. Rent-a-room relief therefore continues to provide an effective incentive for people to make their spare rooms available for rent.

Respondents were positive about the relief being simple and easy to understand. Complicating the relief could lead to non-compliance or could bring taxpayers unnecessarily into self-assessment. It could also result in those with spare accommodation choosing not to rent it out. Proposals to restrict the relief to longer-term lets of 31 consecutive days or more were rejected on these grounds. It was clear that there is a thriving market for letting rooms for very short periods – sometimes just one or two nights – to people such as tourists or mobile workers looking for a cheap place to stay.

The rent-a-room limit will remain at its current level of £7,500 as this was felt to be “sufficiently generous”. This does seem fair if you think of the limit not in terms of the rental returns but in terms of the annual costs to the homeowner of providing that space. Does a spare room cost £625 a month to “run”? Bearing in mind that most of the costs of running the house would have to be incurred anyway, there is an argument that the marginal cost of having the spare room is just pennies. With this in mind, the current limit looks more than fair.

Under the current design of rent-a-room relief, those letting out whole properties as well as spare rooms can benefit. For example, the residents of Wimbledon, London, SW19 can currently let out the whole of their house for a particular fortnight in July and take advantage of the £7,500 rent exemption while simultaneously enjoying a family holiday in Tuscany. This was felt to be incompatible with the intention of the relief.

A new “shared occupancy test” will therefore be incorporated into the relief. The new test will require the taxpayer to be living in the residence and be physically present for at least some part of the letting period for the income to qualify for relief. This amendment is designed to ensure that rent-a-room relief meets its original purpose of incentivising people to let spare rooms rather than whole properties.

Consequently, from 6 April 2019 where a landlord is letting out a whole property, even if it is usually their main residence, they will be unable to claim rent-a-room relief.

The draft amendment to the rent-a-room provisions in S.786 ITTOIA 2005 is that:

“...the use to which the receipts relate is physical use of the furnished accommodation that overlaps in time (wholly or partly) with the use of the residence as sleeping accommodation by the individual or a member of the individual’s household”.

The words “overlaps in time” suggest that just one day of shared occupation with the tenants will be enough to trigger the relief. “Sleeping accommodation” confirms that the shared occupation must be overnight. This could feasibly be the first 24-hours of the rental period where the landlord (or any member of his household) stays under the same roof as the tenants overnight to show them where everything is and how everything works etc, before jetting off on holiday. Incorporating this within the rental agreement would be recommended to support the subsequent relief claim.

The shared occupancy test will apply to each separate letting or rental agreement. For example...

Assume that Sean lives in Edinburgh. Sean hates performance art, alternative comedy, physical theatre and everything and everyone associated with it, so every August for the duration of Edinburgh Fringe Festival he goes to live with his friend in New Zealand. His house is let to visiting tourists. From 2019 the rental receipts will not be eligible for rent-a-room relief as there is no shared occupancy during the period of the rental.

The £1,000 property allowance will however be available. On rents income above £1,000, Sean can choose to either deduct the amount of the allowance or deduct the revenue expenses incurred in letting out the property.

On his return from New Zealand in September 2019, Sean lets a room in his house to a tenant who has a 3-month employment contract in Edinburgh. Sean goes on holiday for 2-weeks during the rental period. In this case the receipts from this rental agreement would be eligible for rent-a-room relief because there is shared occupancy between Sean and his tenant for some part of the rental period. Note here that the rent-a-room limit for the second tenancy would still be £7,500. There is no concept of apportioning the relief based on the length of the tenancy.

### *Conclusion*

There were some concerns that once HMRC had turned a Sauron-like eye to the rent-a-room scheme, its days would be numbered. However common sense has prevailed and it's good to see that a relief which is easy to use, easy to understand and does what it says on the tin has been retained with just a few tweaks. Here's to another 25 years....

*Contributed by Steve Sanders*